



# Tracking Tax Reform: Fall 2017 Update

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On September 27 the “Big Six,” which includes Treasury Secretary Steven Mnuchin, National Economic Council Director Gary Cohn, and other top Republicans in the House and Senate, released the “Unified Framework for Fixing Our Broken Tax Code,” which is to serve as the framework for the tax legislation that they hope to pass by the end of this year. The framework (hereinafter referred to as the “Big Six Framework”) is high-level and many important aspects have few details, but it is the most detailed plan put forth this year. The Big Six Framework differs from the House Republicans proposals in their 2016 blueprint titled “A Better Way” (hereinafter referred to as the “House 2016 Blueprint”), and also from President Trump’s one-page plan that was released in April 2017 (hereinafter referred to as “Trump’s 2017 Plan”). A review of the three different proposals demonstrates the evolution of the tax reform process and the political and policy choices that have already been made. Many more choices will continue to be made in the weeks ahead.

The Big Six Framework is bold, but it could still undergo many modifications before Republicans reach the point of the framework becoming law. As it stands, many details have been left open to be worked out by Congress. We will continue to provide updates when appropriate to help you keep track of the framework as Republicans work to get it through Congress.

## Individual Taxation.

### Rates.

- The House 2016 Blueprint proposed condensing the current eight brackets (ranging from 10% to 39.6%) into three brackets – 12%, 25%, and 33%, dropping the highest income bracket by more than 6 percentage points, or about 17%. The blueprint called for the elimination of the “death tax” (i.e. the estate tax), which applies an additional tax on individuals who die with an estate worth over \$5.49 million (\$10.98 million for married couples).
- Trump’s 2017 Plan proposed reducing the number of tax brackets down to three brackets – 10%, 25%, and 35%. The plan did not include the income levels that would apply to those rates, but insisted that it would provide tax relief to middle-income families. President Trump also called for the repeal of the death tax.
- The Big Six Framework proposed three tax brackets – 12%, 25%, and 35%, but leaves the door open for an additional top rate to apply to the highest-income taxpayers. The framework did not include the income levels that would apply to those rates. The framework repeals the death tax.

### Deductions.

- The House 2016 Blueprint proposed almost a complete elimination of the itemized deduction system in exchange for a higher standard deduction. The mortgage interest and charitable contribution deductions were the only deductions that would remain.
- Trump’s 2017 Plan proposed doubling the standard deduction to \$12,700 for individuals and \$24,000 for married couples filing jointly (but eliminates the personal exemption). President Trump proposed the elimination of all tax deductions other than for mortgage interest and charitable contributions. The plan did not specifically address the federal tax deduction for state and local income tax.
- The Big Six Framework nearly doubles the standard deduction to \$12,000 for individuals and \$24,000 for married couples filing jointly (but eliminates the personal exemption). The framework eliminates the federal tax deduction for state and local income tax. The mortgage interest and charitable contribution deductions are retained.

### Elimination of the Alternative Minimum Tax.

- The House 2016 Blueprint called for the complete elimination of the Alternative Minimum Tax for individuals and corporations.
- Trump's 2017 Plan called for the complete elimination of the Alternative Minimum Tax for individuals.
- The Big Six Framework proposes the complete elimination of the Alternative Minimum Tax for individuals.

### Taxation of investment income.

- The House 2016 Blueprint proposed taxing an individual's investment income (defined to include interest – which is currently taxed at ordinary rates, capital gains, and dividends) at 50% of that individual's ordinary income tax rate – bringing the top rate down to 16.5%.
- Trump's 2017 Plan proposed maintaining the current taxation system for dividends and capital gains, leaving the top rate at 20%.
- The Big Six Framework does not contain a proposal regarding the tax treatment of capital gains and dividends.

### Business Entity Taxation.

#### Rates.

- The House 2016 Blueprint proposed a 20% tax on corporate income, down from the current 35%.
- Trump's 2017 Plan proposed a flat 15% tax on corporate income.
- The Big Six Framework proposes a 20% corporate tax rate.

#### Taxation of pass-through income to entity owners.

- The House 2016 Blueprint proposed taxing active business income derived from pass-through entities (i.e., S corporations, LLCs, partnerships) to their owners at a maximum rate of 25%, rather than the ordinary individual income tax rates that such income is currently taxed at. These rates would be applied to active business income after the deemed payment of "reasonable compensation" to owners and partners that also provide services to the entity, as a means of preventing tax avoidance, but it was not clear how reasonable compensation would be calculated.
- Trump's 2017 Plan proposed taxing income derived from pass-through entities to their owners at a rate of 15%, rather than the ordinary individual income tax rates. Treasury Secretary Mnuchin insisted that the administration will "make sure that there are rules in place so that wealthy people can't create pass-throughs and use that as a mechanism to avoid paying the tax rate they should be paying on the personal side."
- The Big Six Framework proposes taxing income derived from pass-through entities to their owners at a rate of 25%, rather than the ordinary individual income tax rates, and leaves it up to Congress to classify whether income is wages or business profits.

#### Changes to depreciation and interest deductions.

- The House 2016 Blueprint proposed that businesses be allowed to immediately and fully expense 100% of all business investments (other than land), which is a stark contrast to the current complex depreciation and amortization systems that space deductions out over varying periods of years. The blueprint limited the deduction of interest expenses to the amount of interest income, but allowed corporations to carry forward unused interest expenses indefinitely.
- Trump's 2017 Plan did not make any specific proposals regarding depreciation or interest deductions.
- The Big Six Framework allows businesses to immediately expense new investments in depreciable assets other than structures made after September 27, 2017 for at least five years. The framework also calls for the limitation of interest deductibility, but does not give details regarding the limitation.

#### Business incentives.

- The House 2016 Blueprint called for the general elimination of business incentives and credits, other than the R&D credit, which would remain intact. The blueprint proposed that net operating losses be allowed to be carried forward indefinitely (with no carrybacks) and be increased by an adjustment factor to account for inflation. The amount of the deduction allowed with respect to a carryforward would be limited to 90% of the taxpayer's net taxable income for any year.
- Trump's 2017 Plan stated the intention to eliminate tax breaks for special interests, but did not provide further details.
- The Big Six Framework retains the R&D credit and the low-income housing credit, but encourages Congress to eliminate other business credits.

#### Carried Interest.

- The House 2016 Blueprint did not put forth a specific proposal regarding carried interests.
- Trump's 2017 Plan did not make any statement or proposal regarding carried interests. President Trump has previously stated that he will tax carried interest income as ordinary income.

- The Big Six Framework also did not include any mention of a proposal regarding carried interests, but the White House still insists that the reform of carried interest tax treatment is a priority.

### International Taxation.

#### Tax on future foreign earnings.

- The House 2016 Blueprint proposed moving to a territorial system, which would not impose a tax on corporate income earned outside of the United States, even when that income is repatriated.
- Trump's 2017 Plan proposed adopting a territorial tax system.
- The Big Six Framework proposes moving to a territorial tax system. The framework also calls for, but does not provide details regarding, a global minimum tax intended to protect the U.S. tax base and "level the playing field between U.S.-headquartered parent companies and foreign-headquartered parent companies."

#### Tax on accumulated foreign earnings.

- House 2016 Blueprint proposed that accumulated foreign earnings be subject to a mandatory 8.75% tax (for cash and cash equivalents) and a 3.5% tax (for other holdings), with the tax payable over eight years.
- Trump's 2017 Plan proposed a one-time mandatory tax "on trillions of dollars held overseas," but did not elaborate on what tax rate might apply to those accumulated offshore earnings, only that it would be a "competitive rate."
- The Big Six Framework proposes a one-time tax on previously accumulated foreign earnings. The framework calls for a higher tax rate on liquid foreign assets and a lower tax rate on illiquid foreign assets, but does not specify either rate.

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